

CAPITAL PROJECTS AND BOND OVERSIGHT COMMITTEE

Minutes

November 20, 2001

The Capital Projects and Bond Oversight Committee was held on Tuesday, November 20, 2001, at 1:00 PM, in Room 129 of the Capitol Annex. Representative Jodie Haydon, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Representative Jodie Haydon, Chair; Senator Robert Leeper, Vice Chairman; Senators Tom Buford and Bob Jackson; Representatives Bob Damron and Paul Marcotte.

Guests testifying before the committee: Robin Kinney, Jim Abbott, Don Mullis, and Tom Howard, Finance and Administration Cabinet; Dennis Taulbee, Council on Postsecondary Education; John Cubine, Attorney General's Office; Bob McBeath, Office of the Auditor of Public Accounts Office; Bill Hintze, Governor's Office for Policy and Management; Bob Bender, Department of Parks; Warren Nash, Cabinet for Economic Development; and Debby Milton, Kentucky Infrastructure Authority.

LRC Staff: Mary Lynn Collins, Pat Ingram, Kevin Mason, and Shawn Bowen.

Representative Damron made a motion to approve the minutes of the October 16, 2001 meeting as submitted. The motion was seconded by Representative Marcotte and passed by voice vote.

Chairman Haydon said that several months ago Western Kentucky University (WKU) submitted to the committee an unusual funding proposal for the renovation of E. A. Diddle Arena. At that time, the committee asked various state agencies to study not only the specific proposal, but to also study what the review process should be for future such proposals. Chairman Haydon said the Working Group that was formed as a result of the request has completed its report, and Robin Kinney, Deputy Secretary of the Finance Cabinet, is present to discuss the report with the committee.

Ms. Kinney introduced the other members of the Working Group: Dennis Taulbee, Council on Postsecondary Education; John Cubine, Attorney General's Office; and Robert McBeath, Auditor of Public Accounts Office. Ms. Kinney said there will be more alternative financing proposals coming before the Finance and Administration Cabinet and the General Assembly as universities explore different approaches for renovating and improving their auxiliary facilities.

Ms. Kinney said one of the issues that arose with the WKU project was a proposal to transfer title of E.A. Diddle Arena to the City of Bowling Green. She said currently there are statutes in place that address the disposal of property by the Commonwealth and by universities. Universities are required to go through an appraisal process to be approved by the Secretary of the Finance Cabinet. She said the Working Group did not recommend any statutory changes in this process.

Ms. Kinney noted the current proposal relating to E.A. Diddle Arena is for the university to maintain title to the property with financing for the renovation by the City of Bowling Green through general obligation bonds. She said the state's primary interest in such proposals is to make sure that whenever alternative financing arrangements are proposed, the state's debt capacity is not adversely affected. Therefore, Ms. Kinney said it is very important that each project with an alternative financing arrangement be reviewed individually.

Ms. Kinney said the Working Group believes that in cases where state property is transferred and the financing is handled by someone else, but the property will continue to be used for the benefit of the state, any improvements associated with the property should still be deemed a capital construction project and the appropriate approvals should be secured before that project moves forward. She said the statutes might fall short in this area.

Ms. Kinney said universities should seek approval for such projects from the General Assembly; however, she said the Cabinet understands there could be times when approval during the interim is necessary. Mr. Cubine said now that the General Assembly meets annually, there is only a nine-month period each year that the General Assembly would not have a chance to address proposals during its regular session. He said the circumstances in which this type of review process is needed should be extremely limited.

Senator Buford asked about legal fees related to E.A. Diddle Arena. Mr. Cubine said he had talked with Deborah Wilkins, General Counsel for WKU, who indicated there had not been any personal service contracts issued by WKU to pay legal fees for the E.A. Diddle Arena project, and no money has been disbursed.

Representative Damron asked if the Auditor's Office will review the payments of title insurance made by the WKU Student Life Foundation. (WKU transferred ownership of all its dormitories to the Foundation last year.) Mr. McBeath said he had requested, and would be reviewing the Foundation's unaudited financial statements, the minutes of the Student Life Foundation Board meetings, and any other information the Foundation provides. He said no one in the Auditor's Office has seen any document that shows payment for title insurance. Mr. McBeath said he had a conversation with the

Foundation's president, Mr. Cole, who acknowledged that a question about title insurance is being investigated.

Representative Damron asked if the Working Group was aware of state government paying title insurance fees on projects when the state acquires property. Ms. Kinney said she was not. Mr. Hintze said it is very rare for the state to pay title insurance when it acquires property.

Representative Damron asked if the Attorney General's Office is making sure no laws were violated and no money was misappropriated. Mr. Cubine said there was a question raised in a *Courier-Journal* news article as to whether the WKU Student Life Foundation should be required to register as a charitable solicitor since it was a non-profit corporation. He said in response to an inquiry by his office, the Foundation had indicated the only revenue they receive is generated from student dormitory fees. He said his office has also had some discussions with the State Auditor's Office and they will also review the documents requested by the Auditor.

Mr. Cubine said the Working Group report recommends two provisions: (1) all fees paid for services related to a project managed by a non-state entity should be comparable to what state government would pay on a similar project, and (2) all transaction-related documents should be submitted to the Finance Cabinet.

Representative Damron said he understood the reason to build audit trails for future investigations. He asked again if anyone is looking into the issue of \$225,000 in title insurance fees paid by the WKU Student Life Foundation. Mr. Cubine said the Attorney General's Office does not have a current open investigation in the matter. He said title insurance does not appear to be a charge that would normally be seen in such a transaction, and key questions that have not been answered are: who asked that title insurance be provided, in what amount, and when did title insurance become part of the deal.

Representative Marcotte said the Working Group appears to have stopped short of recommending an interim process, and asked if there really is a need for an interim review process, given the fact that the legislature now meets annually. Ms. Kinney said there still may be projects that because of time constraints, need to be started very quickly. She asked Mr. Taulbee to further elaborate. Mr. Taulbee said the Working Group was concerned that a situation might arise where there is a donor or source of funds that was not known or available during the session, and that there might be limited time to react to such opportunity. He said an institution should not be precluded from being able to act on an interim basis in extraordinary circumstances.

Chairman Haydon thanked the Working Group members for their presentation. He then introduced Ken Clevidence, Vice President for Fiscal Affairs, University of

Kentucky (UK), and Dall Clark, Director of Capital Project Management, UK, to discuss a modification for the UK Hospital Parking Structure I project and to update the committee on the UK Administration Building restoration.

Mr. Clevidence said the university is reporting its plan to modify an authorized parking project by expanding an existing parking structure located on UK's central campus. The authorized project was to have been a new parking structure to address parking around the University Hospital. The university is proposing to modify the project by adding two levels (400 spaces) to existing Parking Structure #5 on UK's central campus, and then moving commuter students from a lot near the hospital to the expanded facility. This will leave the remaining parking inventory available for hospital personnel. Mr. Clevidence estimated the cost of this project to be approximately \$6 million, and the university plans to allocate \$3.5 million from parking fund balances and \$2.5 million from the Hospital's agency funds.

Senator Buford made a motion to approve the project modification for the UK Hospital Parking Structure I project. The motion was seconded by Representative Damron and passed by voice vote.

Mr. Clevidence said on May 15, 2001, there was a fire in the Administration Building which caused extensive damage. He asked Mr. Clark to further discuss plans to restore that building.

Mr. Clark said they were very pleased with the current progress of this project. The building is structurally sound and can be rebuilt. He said there is now a temporary shed roof on the building that will last through the winter, and asbestos abatement has been completed. All the openings to the building have been temporarily closed. The university has completed selective demolition on the project, and some temporary lighting and heating has been installed in the building to protect the building throughout the oncoming winter season.

Mr. Clark said they have been working with a preservation advisory group, and the local architectural firm of Potts Architects is being hired as the prime consultant; Staggs and Fisher Engineering will be responsible for the mechanical, electrical and plumbing work. They are also negotiating with Climate and Hallsband of New York. This firm has a good national reputation, and has received over forty architectural awards across the country. The university plans to add a plaza entry to the rear or to the campus side of the building, and is considering adding classrooms.

Mr. Clark closed by saying the university has a tentative agreement with the state fire and tornado fund, and is very close to receiving an insurance settlement.

Chairman Haydon said the University of Louisville had submitted a project report for the committee's review. The school is reporting the purchase of scientific research equipment (a Bioflo 5100 mobile plant fermentor) at a cost of \$135,062. Chairman Haydon said no further action was required for this project.

Chairman Haydon then asked Mr. Bill Hintze, Governor's Office for Policy and Management (GOPM), and Commissioner Armond Russ, Department for Facilities Management, to discuss the project report submitted by the Finance and Administration Cabinet.

Mr. Hintze reported a \$650,000 allocation from the Emergency Repair, Maintenance and Replacement Fund for the Kentucky State Reformatory's Central Administration Building. This project was authorized by the 2000 General Assembly for \$1,600,000. Money from the Emergency Fund will be used to repair structural steel damage not identified in an earlier assessment. The revised project scope is \$2,250,000. Chairman Haydon said no action is required for emergency fund allocations.

Senator Leeper said he had a question about another Corrections facility. He noted that according to a staff report on the Green River Correctional Complex, ten of the original thirteen buildings, completed only seven years ago, have documented roof failures. He asked if there is any recourse from the contractor or manufacturer of the roof materials. Commissioner Russ said the metal roof system at Green River was installed improperly by the contractor. He said they have been working diligently since it was built to try to resolve the issue, but unfortunately, the contractor went bankrupt. Mr. Hintze said Green River is the newest prison and it is disturbing to think the state may have to spend millions of dollars to repair the newest roofs in the system. He added that while they are trying to avoid having to use Emergency funds, new roofs for this institution will be a high priority for the Cabinet in the regular budget if they can wait that long.

In response to another question from Senator Leeper, Commissioner Russ said the roof leak at Green River is an installation problem. He said the problem is not with all of the buildings, but some of the buildings. The problem was documented at the close of construction, but the contractor would not respond to their requests to fix the problem. Mr. Hintze said they are trying to see if there are any legal means to rectify the problem, but they do not at this time know of any satisfactory resolution to this problem.

Mr. Hintze reported a \$59,600 scope increase for the Transportation Cabinet's Elizabethtown District Office Building project. This project was approved by the 2000 General Assembly at a scope of \$3,810,000 (Road Funds). Mr. Hintze said the scope increase will be funded with Highway Construction Contingency Account funds, and is necessary to meet the low bid on the project.

Representative Damron made a motion to approve the scope increase. The motion was seconded by Representative Marcotte and passed by voice vote. The revised project scope is \$3,869,600.

Mr. Hintze then reported an unbudgeted capital equipment project at a scope of \$175,000 for the Natural Resources and Environmental Protection Cabinet (NREPC). The Cabinet plans to purchase an inductively coupled plasma mass spectrometer which will be used primarily for advanced metals detection. The project is 100% federally funded.

Representative Damron made a motion to approve the unbudgeted project. The motion was seconded by Senator Buford and passed by voice vote.

Mr. Hintze next reported a \$70,000 scope increase for the NREPC Maxey Flats Replacement Structures project. This project was authorized by the 2000 General Assembly at a scope of \$390,000. Mr. Hintze said the scope increase will be funded with \$10,000 in agency funds and \$60,000 from the Capital Construction and Equipment Purchase Contingency Account. The scope increase is needed to meet the low bid on the project.

Representative Damron made a motion to approve the scope increase. The motion was seconded by Senator Buford and passed by voice vote. The revised project scope is \$460,000.

The final project Mr. Hintze reported was a contingency account allocation for the New Conference Center project at Dale Hollow State Park. This project was approved by the 2000 General Assembly at a scope of \$2,150,000 (Bond Funds). Mr. Hintze said the construction bids came in over scope, and Secretary Flannery agreed to recommend \$322,500 from the Contingency Account to meet the low bid. Mr. Hintze said as a companion to this project, there will an expansion of the parking lot which serves the lodge, and will also serve the new Conference Center. The funding source for the parking lot expansion will be the Department of Parks' biennial road fund maintenance appropriation.

Senator Leeper asked if it unusual to use the maintenance pool for new pavement. Mr. Hintze said this is not an unusual use of road funds. He said this has been done many times before, although it is not usually coupled with a bid on a larger project development.

Senator Leeper asked what projects the Department had planned to fund from the road maintenance pool that might not be funded as a result of this decision. Mr. Bob Bender, Department of Parks, said that the Department had a \$2 million budget for the fiscal year. He said within the budget, there are three projects now in design: a pedestrian

bridge at Blue Licks; a project at Big Bone Lick which involves a new box culvert system, along with entrance road improvements; and a project to re-gravel a parking lot at Green River State Park. Two other projects are planned: paving and new guardrails at Natural Bridge; and major repairs to the existing bridge at Levi Jackson. Mr. Bender acknowledged that one or a combination of those five projects will be delayed to fund the Dale Hollow Parking Lot project because this is a high priority for the Department.

Representative Damron made a motion to approve the contingency allocation. The motion was seconded by Senator Leeper and passed by voice vote. The revised project scope is \$2,472,500.

Next, Mr. Jim Abbott, Director, Division of Real Properties, reported five state agency leases with space modifications for the period of July through September. Chairman Haydon said no action is required for lease modifications under \$50,000.

Chairman Haydon then called on Mr. Don Mullis, Executive Director of the Office of Financial Management, to discuss an update on Kentucky's issuer credit rating.

Mr. Mullis discussed the recent action taken by Standard and Poors (S&P) with regard to the outlook for Kentucky's general obligation credit rating. He said on October 29, S&P published a rating that changed the state's outlook from "stable" to "negative". While the state no longer issues general obligation bonds, both S&P and Moody's issue "shadow" ratings - AA credit from S&P, and Aa2 from Moody's.

Mr. Mullis said S&P believes that Kentucky has not taken the necessary steps to structurally balance its budget, and the agency is looking to see how the General Assembly and the Executive Branch address these issues in the upcoming budget session. He said failure to establish structural balance with the next biennial budget would likely result in a ratings downgrade.

Mr. Mullis said the other two rating agencies have not taken similar steps. Moody's and Fitch are both very comfortable with the state's credit at this point, and they have not raised any significant issues. He said they understand that all states are facing some revenue problems. He added, however, all three rating agencies are waiting to see the budget the 2002 General Assembly enacts before they take any additional steps.

Mr. Mullis said in 1993, S&P took a very similar action by placing the state on "negative outlook". As a result of that action, the General Assembly in conjunction with the Executive Branch took various corrective actions which led to the establishment by statute of the Budget Reserve Trust Fund and the implementation of the consensus forecasting process.

Mr. Mullis said shortly after this latest report by S&P was published, the state issued bonds, and the state continues to have a AA credit with very strong and positive pricing. He said the debt program of the Commonwealth is still very highly regarded, but there are some issues that need to be addressed.

Representative Damron asked what would be the cost to the Commonwealth if the state's issuer credit rating is downgraded to A. Mr. Mullis said it would cost the state approximately \$2,000 per \$1 million in bonds issued. He also noted the state has a lot of bonds outstanding that have been sold under current authorizations as AA credits. The loss of the AA not only affects the state's future funding, it also affects the holdings of people who currently have state bonds in their portfolio who may decide to sell those bonds into the market place, possibly at a lower price.

Representative Damron said if the state does not take some steps to solve its financial problems, it could be further penalized. He said the state cannot bond its way out of trouble or into prosperity.

Representative Marcotte asked how frequently S&P reviews ratings. Mr. Mullis said the state credit rating is done in June. However, each of the rating agencies has an opportunity to make a statement or comment when they review subsequent bond issues.

In response to a question from Representative Damron, Tom Howard, Deputy Executive Director, Office of Financial Management, said the state's ability to refund bonds would also be significantly affected if the state's bond rating was downgraded.

In response to another question from Representative Damron, Mr. Howard said the only outstanding debt of the Asset Liability Commission is a Tax and Revenue Anticipation Note. Mr. Howard said all of the state's bond anticipation notes have been converted to permanent financing at very attractive rates.

Mr. Howard next presented the agency's bond activity report. He first reported three new bond issues: Kentucky Housing Corporation Housing Revenue Bonds, 2002 Series A (Non-AMT) (\$210,745,000) and 2002 Series B (AMT) (\$50,000,000); Kentucky Housing Corporation Single-Family Mortgage Revenue Bonds, Draw Down Series 2001 (\$250,000,000); and Kentucky Infrastructure Authority Revenue and Revenue Refunding Bonds in five series (\$99,765,000).

Representative Damron asked why the Kentucky Housing Corporation Series A bonds had a call date of 2013. Mr. Howard said there are a multitude of call options associated with housing bonds. There are actually five embedded call options from a variety of sources for those bonds, and the optional call is usually the last of those options exercised.

Representative Damron asked if the call date has to be that long in order to sell the bonds at 4%. Mr. Howard said the call date should have been 2012 - the date of 2013 was a typographical error. He said ten years is a standard optional call.

Representative Marcotte made a motion to approve the three new bond issues. The motion was seconded by Senator Buford and passed by voice vote.

Next, Mr. Howard discussed a follow-up report for a previously approved bond issue: State Property and Buildings Commission Revenue Refunding Bonds, Project No. 72 (\$223,730,000). Chairman Haydon said no action is required for follow-up reports.

Lastly, Mr. Mullis reported two new bond issues with School Facilities Construction Commission (SFCC) debt service participation: Kenton County and Pineville Independent (Bell County).

Senator Buford made a motion to approve the school bond issues with SFCC debt service participation. The motion was seconded by Senator Leeper and passed by voice vote. Representative Damron abstained from the vote, citing a potential conflict of interest.

Chairman Haydon said there were seven locally funded school bond issues submitted to the committee for review this month: Eminence Independent (Henry County), Grant County, Pulaski County, and the Kentucky Interlocal School Transportation Association. He said all disclosure information has been filed, and no further action on these bond issues is required.

Chairman Haydon next introduced Debby Milton, Kentucky Infrastructure Authority (KIA), to present two projects proposed for KIA assistance: an additional \$75,000 from Fund E (Solid Waste Grant and Loan Fund) for Pike County for a total of \$150,000. The grant is for the Certified Clean Counties Program, and will be used to clean up open dumps, and one new Fund F (Federally Assisted Drinking Water Revolving Loan Fund) loan in the amount of \$2,444,505 for the City of Grayson in Carter County. These funds will be used to rehabilitate and expand the current water treatment plant.

Senator Jackson made a motion to approve the two KIA projects. The motion was seconded by Senator Leeper and passed by voice vote.

Chairman Haydon next introduced Warren Nash, Director of the Grants Programs, Economic Development Cabinet. Mr. Nash presented an Economic Development Bond (EDB) project to benefit the Southern Kentucky Economic Development Corporation (SKEDC). The Cabinet is proposing to make a grant of \$400,000 to the company, through Pulaski County Government. Proceeds will be used to construct an information

technology center to be located in a 150-acre technology park. The center will be used to attract technology-intensive companies to Somerset. Mr. Nash said SKEDC will be required to recruit industry to the information technologies center that will in turn create a minimum of forty full time jobs within two years of completion and occupancy of the center. If they fail to meet that job requirement, they will have to pay back to Pulaski County \$10,000 per job not created within the forgoing time period.

Representative Damron made a motion to approve the EDB grant. The motion was seconded by Senator Buford and passed by voice vote.

Mary Lynn Collins, Committee Staff Administrator, reviewed various correspondence items in members' folders. Among the items she reviewed was a letter transmitted from Finance Secretary Kevin Flannery to the committee, updating the committee on three contracts recently awarded under the design-build construction delivery method and a staff-written issue paper on some of the issues related to alternative construction delivery methods.

Chairman Haydon said the next meeting is scheduled for December 18. He said Representative Perry Clark, the Chair of the Capital Planning Advisory Board, will present recommendations recently adopted by the Board.

Representative Damron made a motion to adjourn the meeting. The motion was seconded by Senator Buford and passed by voice vote. The meeting adjourned at 2:30 p.m.